NEW ZEALAND
STEEL

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NZ ETS Review Consultation
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To Whom It May Concern

New Zealand Steel submission on the ETS Review 2016

Thank you for the opportunity to share New Zealand Steel's view on the important issues involved in reviewing the New Zealand ETS.

We look forward to working with Government to achieve a sustainable and economically viable future for the South Auckland region and wider New Zealand.

This is a submission on the second round of questions that relate to business responses to the NZ ETS, as outlined in the discussion document.

The specific answers provided below are made in the broader context of the New Zealand Steel position statement on the ETS review which is:

- New Zealand Steel wants steel making exempt from the ETS for the same reasons that the Government exempts agriculture. Failing that, New Zealand Steel wants continued mechanisms in place to off-set the full costs of the ETS.

- If, however, there was a move to increase obligations, the only options as we see it, would be to increase the free allocations to New Zealand Steel, to 100 per cent.

- The higher the net costs to New Zealand Steel arising from ETS relative to that faced by steel makers worldwide, the higher the likelihood we will need to move to our contingency strategy and close our steel make operations in New Zealand.

Submission summary

As outlined in our previous submission, New Zealand Steel is significantly exposed to the ETS. We reiterate that there are three factors specific to steel making in New Zealand that must be considered in this review.

1. **New Zealand Steel is globally trade exposed.** We compete in import and export markets, where other countries do not place mandatory carbon costs on their steel industries. Competition in a solely domestic market is largely unaffected by the ETS

because all manufacturers face the same impost. This is not the case for New Zealand Steel, which faces global market competition.

2. Our emissions are not by choice. The majority of emissions are a physical result of the chemical reactions required when manufacturing steel products, with the majority of emissions attributable to the chemical process that uses carbon (in coal and coke) to extract iron from iron sands. There is currently no commercially viable technology for manufacturing virgin iron and steel worldwide that does not use carbon. Similar to methane emissions in the agriculture sector, it is simply not a choice whereby we can switch to a lower carbon emitting product or supplier. Carbon is an intrinsic requirement of the steelmaking process.

3. The global steel industry is in downturn. Our February submission noted world steel prices at a historical low. Since then, there has been some recovery in steel prices but uncertainty for world steel production and markets means New Zealand Steel's trading conditions continue to be worse that those faced during the GFC. The business continues to be loss making.

An increased cost from the ETS would have a significant financial impact on New Zealand Steel. In competing in the current global environment, New Zealand Steel cannot afford to be impacted by significant costs that other steel manufacturers do not face.

Introduction to New Zealand Steel

New Zealand Steel has contributed to the New Zealand economy for 50 years. We operate a fully integrated steel mill in Glenbrook, South Auckland, manufacturing a large range of steel products from locally sourced materials for use in the building, construction, manufacturing and agricultural sectors.

New Zealand Steel contributes around 1 per cent of New Zealand's GDP, employs around 1500 people and indirectly creates employment for a further 5000 people.

We are part of a wider metals industry, which contributes over 7 per cent to annual New Zealand GDP. Furthermore, direct metals-based product manufacturing employs over 26,000 people.

New Zealand Steel is supportive of climate improvement initiatives. Examples of this include: Lanzatech bio-ethanol pilot plant; ownership and management of the Taharoa forestry complex; Biomass coke sources (CarbonScape); cogeneration of 60 per cent of the site electricity requirement and a number of energy conservation projects.

Response to specific discussion document questions - Part 2.

Other issues: business responses to the NZ ETS

We consider the future cost of emissions in our business planning because it represents a material expense to our business. As the future cost of emissions for our business is uncertain, we run a number of scenarios.
The majority of New Zealand Steel emissions arise from the use of coal as the only viable carbon source in the production of steel. Therefore our business planning has only two realistic options:

Option one: Maintaining iron and steel manufacturing at Glenbrook, with a drive for least-cost production

If this is not economically viable due to costs imposed on the business, then:

Option two: Having an active contingency plan for the closure of our primary operations – more than half the New Zealand Steel business, likely affecting 800-1000 direct jobs

The three factors that impact a decision to move to option two are:

- International steel prices
- Exchange rates
- Our cost base - exposure to carbon costs not faced by other steel makers around the world could represent a material part of this equation.

Importantly, long term policy stability with the reassurance that New Zealand Steel will not bear carbon costs until its major foreign competitors face comparable costs is essential.

Other issues: protecting competitiveness through free allocation

New Zealand Steel is competing internationally (both on exports and domestic Import Price Parity). Abatement of allocations should only commence when there is clear evidence that other steel businesses around the world are subject to similar carbon costs.

Unless other steel makers around the world have similar costs, iron and steel making in New Zealand will become uncompetitive and ultimately unsustainable. The rate of reduction in allocations, relative to the requirement for sustaining capital to maintain production, will determine the timeframe for closure.

Despite some recent recovery in world steel prices, external analysts continue to note the fragility of the situation. They have highlighted the risk of a significant softening in the global steel market recovery, combined with New Zealand Steel earnings that are sensitive to global steel prices and exchange rates. At 31 December 2015, New Zealand Steel's primary steel making asset values were impaired by $196m as a consequence of these business conditions, including actions by international competitors who do not face carbon costs.

Other issues: managing unit supply- forestry

We have reservations on the relative short term nature of the benefit of forests in absorbing carbon. While a forest is growing it obviously absorbs carbon, once a forest reaches a natural harvest cycle or equilibrium it provides no net annual carbon abatement. Therefore, we do not believe forestry provides a solution for long term abatement of carbon. At best, it will buy time for alternative technologies and strategies to be developed and implemented. At worst, it may create incentives for foresters which mask a longer term issue and lead to an unbalanced market around the ETS.

Other issues: managing unit supply- international units

We expect Government to ensure the units that can be entered in the New Zealand register have integrity. Beyond this, there should be no restrictions.
Participants must be able to use least cost abatement. Administrative intervention distorts market outcomes.

Other issues: managing unit supply- auctioning

This is not a question that can be answered in isolation and calls for wider economic analysis. Auctioning needs to be considered as part of the debate on a New Zealand cap on C02.

This may not be appropriate for a growing economy and needs to be related to economic activity. To do otherwise inhibits growth and/or results in carbon leakage.

The need/benefits of an auctioning system will be impacted by a number of factors including:

- Access to international units
- Expectations regarding supply and demand
- Pricing including the impact from forestry
- Compliance obligations vs. allocations

Government policy impacts on all of these in terms of the degree of certainty around short and long term policy objectives.

Other issues: managing price stability

Government needs to provide a stable market place with mechanisms to avoid manipulation. A stable policy and market platform is more important than price certainty.

Carbon pricing is closely related to government policy, and price stability to the lack of clear long term policy. As such we have an artificial market. Unless there is unrestricted access to quality international units we are completely reliant on the Government for sourcing units (directly and indirectly).

Other issues: operational and technical matters

Participation in the ETS is involved, but not difficult. The structure of the scheme has logic. The administrative requirements take professional dedication but the time required is not disproportionate to the importance of the process.

Compliance requirements and penalties should be reviewed to ensure they are not more onerous than other New Zealand regimes such as the provisions of the Companies Act or Inland Revenue. The $30 per unit penalty is excessive and the decision to be taken by officials is onerous on both parties.

Conclusion

New Zealand Steel appreciates the opportunity to continue to share its view on the NZ ETS review.

In competing in the current global environment, New Zealand Steel cannot afford to be impacted by significant costs that other steel manufacturers do not face.

Government policy will therefore have a significant impact on New Zealand Steel.

The future of New Zealand Steel is, we either maintain iron and steel manufacturing at Glenbrook, with a drive for least-cost production or if this is not economically viable due to costs imposed on the business, then the contingency plan is to close our primary operations – more than half the New Zealand Steel business, likely affecting 800-1000 direct jobs.

In summary, our position statement on the ETS review is that:

- New Zealand Steel wants steel making exempt from the ETS for the same reasons that the Government exempts agriculture. Failing that, New Zealand Steel wants continued mechanisms in place to off-set the full costs of the ETS.

- If, however, there was a move to increase obligations, the only options as we see it, would be to increase the free allocations to New Zealand Steel, to 100 per cent.

- The higher the net costs to New Zealand Steel arising from ETS relative to that faced by steel makers worldwide, the higher the likelihood we will need to move to our contingency strategy and close our steel make operations in New Zealand.

We are available to discuss this matter further should Ministry for the Environment officials wish.

Yours sincerely

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Margaret Gracie
Vice President People & External Affairs